

Aurora Macro Strategies – Italy Gets Serious January 24, 2025

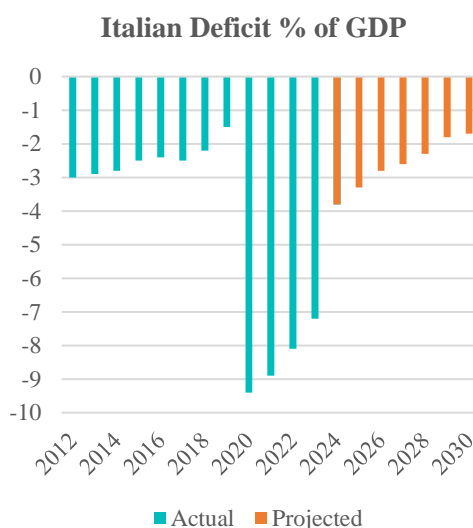
The Tearsheet

- Prime Minister Giorgia Meloni's strong domestic popularity and stable parliamentary majority enabled her to pass a budget for 2025, one of the few major European nations to do so.
- Heavily backed by EU recovery funds, Italy's 2025 budget balances contractionary measures with tax relief, nudging Italy's fiscal affairs toward sustainability.
- Growth has been relatively strong by Italian standards, also benefiting from the steady flow of EU funds.
- Internationally, Meloni has positioned herself as a supporter of continued aid to Ukraine, a bridge between the EU and the Trump administration, and an advocate for European defense reforms and increased European power within NATO.

Jan 29	FOMC Meeting
Jan 29	Jan IT Consumer Confidence
Jan 30	ECB Meeting
Jan 30	4Q24 GDP - Flash
Jan 30	Dec Unemployment
Jan 30	Jan EA Economic Sentiment
Feb 03	Jan CPI - Flash
Feb 23	Germany General Election
Mar 03	Feb CPI - Flash
Mar 04	Jan Unemployment
Mar 06	ECB Meeting
September 2025	Italian Local and Regional Elections
Before 2028	Italian General Election
2029	Italian Presidential Election

1. Meloni's Penne-Pinching Budget

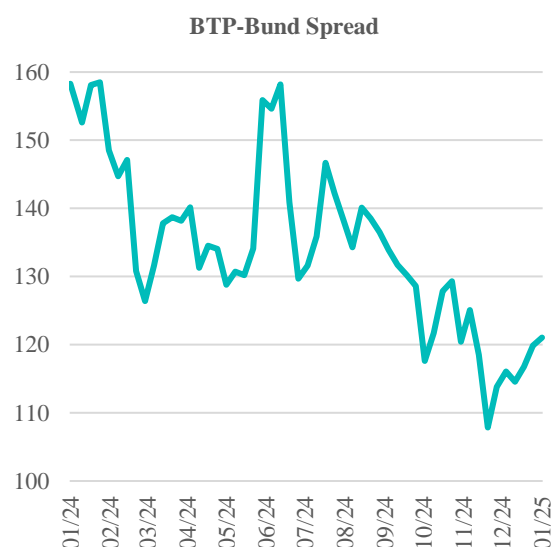
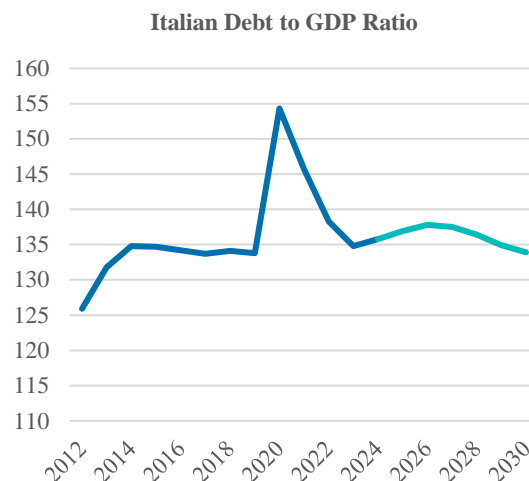
- Italy, currently enjoying one of its most stable political periods in recent years, has been one of the few major European economies to pass a budget for 2025.
- Under increased scrutiny from Brussels and having been placed into the Excessive Deficit Procedure (EDP), Meloni's government passed a contractionary budget that aims to cut spending and reduce the deficit from 3.8% to below the EU's target of 3% by 2026, aiming to exit the EDP in 2027.
- Despite being a deficit delinquent and being placed in EDP, Italy passed the EU's medium-term fiscal assessment and has been granted seven years to comply with the EU's new fiscal rules under the Stability and Growth Pact (SGP).
- Italy's deficit ballooned in 2022 (-8.1%) and 2023 (-7.2%), largely due to the "Superbonus" scheme which alone cost almost 4% of Italy's GDP in 2023. The program is due to be phased out by the end of this year.
- The budget appropriates €30B for tax wedge reductions and a tax bracket reorganization for low and medium (<€40,000) earners, as well as providing tax cuts for businesses, including a reduction in the corporate tax rate from 24% to 20% for companies which reinvest at least 80% of their profits into technological investments and workforce increases.



- The income tax reform introduced in 2024 has been made permanent. For individuals, the first two brackets of the previous system have been merged into a single bracket, with a 23% tax rate applied to incomes up to €28,000 (previously €15,000).
- The budget includes subsidies for food purchases and incentives to boost Italy's birth rate, a key priority for Giorgia Meloni.
- The tax wedge reduction and the reorganization of the tax brackets is estimated to reduce overall annual tax revenue by €18B.
- The budget is to be largely financed by new revenue-raisers placed on the financial and insurance sectors, accounting for €5B in increased revenues in 2025-2026. For a more detailed breakdown of the revenue raising mechanisms, see our latest EU Fiscal Atlas [here](#).
- Additional fiscal capacity is to come from a new cap on tax deductions for individuals earning over €75,000. Deductions will be capped at €14,000 for those earning between €75,000 and €100,000 and at €8,000 for those earning between €100,000 and €120,000.
- In terms of spending pledges, Italy's national health service will see their funding increase by roughly €5B over the next two years with an additional €1.3B for public health facility modernization projects.
- State pensions equal to or below the minimum allowance will increase by 2.2% in 2025 and 1.3% in 2026 in real terms.
- Additional funding includes €1.6B for equipment investments in Southern Italian regions, €35B (2025-2039) for defense investments, and €24B (2027-2036) for infrastructure investments.
- While the 2025 budget allocates minimal national funding for infrastructure investment, Italy is the biggest recipient of the EU's post-covid Recovery and Resilience Facility (RRF).
- The RRF has allocated €194B (€71.8B in grants and €122.6B in loans) to Italy to fund numerous public investments. Loans will be paid back starting 2028 and last until 2048. So far, Italy has received €46.5B out of its grant allocation and taken €75B in loans.
- Therefore, a number of the spending pledges in Meloni's 2025 budget will also be [supplemented](#) by funding from the RRF, which includes €15.7B in funding for improvements to the healthcare system, €10.6B for infrastructure investment in Southern Italy, and €24.7B of RRF funds to finance green transition and waste and water management projects under the Commission's REPowerEU plan.
- Despite the seeming largesse of Italy's RRF funding, Meloni's budget itself is essentially contractionary.

2. A PIG no longer

- Italy has emerged as a relative success story among major European economies in 2024, achieving real GDP growth of 0.7%, close to the Euro area average of 0.8%. In 2023, Italy finally managed to claw back its 2007 real GDP level.
- [Projections](#) indicate further growth of 1% in 2025 and 1.2% in 2026—an improvement over Italy’s historically anemic growth.
- Nonetheless, some of the sluggishness remains: Italy’s inflation is at 1.3%, well below both the Eurozone average (2.4%) and the ECB’s 2% target.
- Italy’s minor success and Germany’s woes over the last year have seen the BTP-Bund spread narrow by ~37 bps (24%).
- Despite these good news, the numerous and entrenched macro challenges to Italy’s economy are harder to overcome. Meloni must grapple with low productivity growth, as well as significant regional economic disparities between the North and South.
- Here too, the NGEU is supposed to help. The European Commission has pinpointed key reforms to fund through the RRF, including:
 - **Judiciary Reform:** Boosting judicial independence and efficiency by shortening proceedings and tackling case backlogs.
 - **Bureaucratic Overhaul:** Enhancing efficiency through major digitization projects, backed by nearly €25B from the RRF.
 - **Economic and Productivity Growth:** Increasing private sector competition, cutting red tape, and incentivizing investment. Earmarked EU funding will allow Italy to disburse €13.8B in tax credits for businesses investing in innovation, R&D, and workforce training.
 - **Education and Workforce Development:** Reducing school dropout rates and introducing programs to upskill and reskill workers in declining industries.

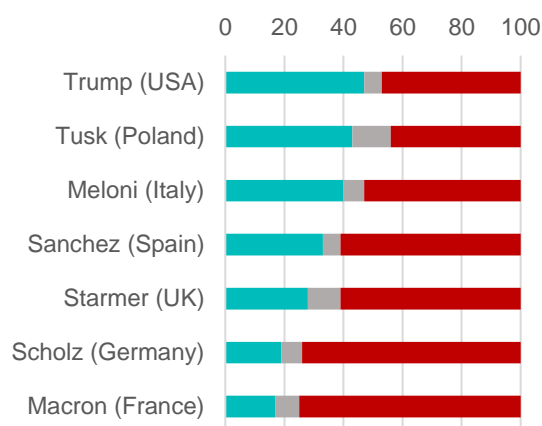


3. La Dolce Leader

- One advantage Meloni has over her colleagues in France, Germany, and the UK is that she is largely popular domestically, as is her party, Fratelli d'Italia (FDI). Indeed, she has been ranked as one of the most powerful politicians in Europe by [POLITICO](#) two years in a row.

- In fact, Meloni is one of the most popular leaders of any major developed economy. She currently has a -13-point approval rating. FDI is also the most popular party in Italy, with a 6 point [lead](#) over the center-left Partito Democratico (PD).
- Despite her Eurosceptic history and leadership of the European Conservatives and Reformists (ECR) group in the European Parliament, Meloni has demonstrated a pragmatic approach to working with the EU during her premiership.
- With Italy's next election not due until 2027, Meloni and FDI have ample time to push through economic reforms.
- Italian politics remains notoriously unpredictable, with public and political support capable of evaporating quickly if economic conditions deteriorate or scandals arise.
- Indeed, it was not all plain sailing for Meloni to get her budget passed. Negotiations took many months and there were numerous—albeit ineffective—[strikes](#) throughout Italy towards the end of 2024.
- However, Meloni and FDI managed to emerge from the negotiation period not only with a budget but with their popularity largely unscathed, thanks in part to her strong command over a stable parliamentary majority and an ineffective and divided parliamentary and trade union opposition.
- Internationally, Meloni is in the good graces of President Donald Trump and the Republican Party. As a frequent invitee to CPAC, a recent visitor to Mar-a-Lago, and an attendee at Trump's inauguration, Meloni is positioning herself as a bridge between the Trump administration and an EU leadership that views it as untrustworthy and dangerous.
- An example of her strong ties to U.S. leadership and her ambition to serve as a key intermediary between the U.S. and global players surfaced during the recent negotiations to free Italian journalist Cecilia Sala from an Iranian prison.
- The deal—securing Sala's release in exchange for Iranian businessman Mohammed Abedini, detained in Italy for supplying drone components to Iran—was brokered through three-way talks involving Italy, Iran, and the U.S.
- Meloni has also developed a close relationship with Elon Musk, one of Trump's closest advisors. SpaceX, Musk's company, is currently in negotiations with her administration on a \$2.4B deal to deploy the Starlink satellite network for secure government communications.
- Despite concerns that the Trump administration might abandon Ukraine, Meloni has firmly [stated](#) that halting aid to Ukraine “would be an error” and has expressed confidence that U.S. support for Ukraine in its war against Russia will continue.
- On January 9th, Meloni underscored this commitment during her meeting with Ukrainian President Volodymyr Zelenskyy in Rome, where she reaffirmed her backing for ongoing international military aid.

World Leader Approval Ratings



Source: Morning Consult, FiveThirtyEight

- Within the EU, Meloni has been a vocal advocate for overhauling the bloc's common defense policy and strengthening European leadership within NATO. Recognizing the Trump administration's increasing skepticism of NATO, she has positioned herself as a potential intermediary between European NATO members and the U.S., emphasizing the importance of transatlantic unity.
- Meloni has proposed "innovative" financing solutions for European defense initiatives, including the issuance of European defense bonds and has lauded investment by the European Investment Bank into defense projects. She has also called for measures to bolster the EIB's capacity, ensuring Europe remains prepared to address future security challenges.

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